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SMALL BUSINESS ADMINISTRATION

Additional Actions Are Needed to Certify and Monitor HUBZone Businesses and Assess Program Results

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Highlights of GAO-08-975T, a testimony before the Committee on Small Business, House of Representatives

SMALL BUSINESS ADMINISTRATION

Additional Actions Are Needed to Certify and Monitor HUBZone Businesses and Assess Program Results

Why GAO Did This Study

The Small Business Administration's (SBA) Historically Underutilized Business Zone (HUBZone) program provides federal contracting assistance to small firms located in economically distressed areas, with the intent of stimulating economic development. Questions have been raised about whether the program is targeting the locations and businesses that Congress intended to assist. This testimony focuses on (1) the criteria and process that SBA uses to identify and map HUBZone areas; (2) the mechanisms SBA uses to ensure that only eligible small businesses participate in the program; and (3) the actions SBA has taken to assess the results of the program and the extent to which federal agencies have met HUBZone contracting goals. To address these objectives, GAO analyzed statutory provisions as well as SBA, Census, and contracting data and interviewed SBA and other federal and local officials.

What GAO Recommends

In the report upon which this testimony is based (GAO-08-643), GAO recommended that the SBA Administrator take steps to ensure that only eligible firms participate in the HUBZone program and further assess the effectiveness of the program. SBA agreed with these recommendations and outlined steps that it plans to take to address them.

What GAO Found

SBA relies on federal law to identify qualified HUBZone areas, and recent statutory changes have resulted in an increase in the number and types of HUBZone areas—changes that could diffuse the economic benefits of the program. Further, the map that SBA uses to help firms interested in participating in the program to determine if they are located in a HUBZone area is inaccurate. Specifically, the map incorrectly includes 50 metropolitan counties and excludes 27 nonmetropolitan counties. As a result, ineligible small businesses participated in the program, and eligible businesses have not been able to participate.

The mechanisms that SBA uses to certify and monitor firms provide limited assurance that only eligible firms participate in the program. Although internal control standards state that agencies should verify information they collect, SBA verifies the information reported by firms on their application or during recertification—its process for monitoring firms—in limited instances and does not follow its own policy of recertifying all firms every 3 years. GAO found that more than 4,600 firms that had been in the program for at least 3 years went unmonitored. Further, SBA lacks a formal policy on how quickly it needs to make a final determination on decertifying firms that may no longer be eligible for the program. Of the more than 3,600 firms proposed for decertification in fiscal years 2006 and 2007, more than 1,400 were not processed within 60 days—SBA's unwritten target. As a result of these weaknesses, there is an increased risk that ineligible firms have participated in the program and had opportunities to receive federal contracts.

SBA has taken limited steps to assess the effectiveness of the HUBZone program, and from 2003 to 2006 federal agencies did not meet the government-wide contracting goal for the HUBZone program. Federal agencies are required to identify results-oriented goals and measure performance toward the achievement of their goals. SBA tracks the number of firms certified or recertified, the annual value of contracts awarded to HUBZone firms, and the number of program examinations completed annually, but has not devoted resources to completing an evaluation of the program. Consequently, SBA lacks key information that could help it better manage and assess the results of the program. Finally, most federal agencies did not meet their HUBZone contracting goals during fiscal year 2006, the most recent year for which we had data. While the percentage of prime contracting dollars awarded to HUBZone firms increased in each fiscal year from 2003 to 2006, the 2006 awards fell short of the government-wide 3 percent goal by about one-third.

Madam Chairwoman and Members of the Committee:

I am pleased to be here today to discuss the Small Business Administration's (SBA) Historically Underutilized Business Zone (HUBZone) program. Created in 1997, the HUBZone program provides federal contracting assistance to small businesses located in economically distressed communities, or HUBZone areas, with the intent of stimulating economic development in those areas. In fiscal year 2007, federal agencies awarded contracts valued at about \$8 billion to HUBZone firms. Firms that participate in the program must be located in a HUBZone and employ residents of HUBZones to facilitate the goal of bringing capital and employment opportunities to distressed areas. There are more than 14,000 HUBZone areas, and, as of February 2008, almost 13,000 firms participated in the program. Further, to support and encourage the development of small businesses in HUBZones, Congress has set a goal for federal agencies to award 3 percent of their annual contracting dollars to qualifying firms located in HUBZones.

My statement today is based on our June 2008 report that is being made public today, which discussed SBA's administration and oversight of the HUBZone program.¹ In my testimony, I will discuss (1) the criteria and process that SBA uses to identify and map HUBZone areas; (2) SBA mechanisms to ensure that only eligible small businesses participate in the HUBZone program; and (3) steps SBA has taken to assess the results of the program and the extent to which federal agencies have met their HUBZone contracting goals.

To assess the accuracy of the HUBZone map, we reviewed applicable statutes, regulations, and agency documents. We also interviewed SBA's mapping contractor and reviewed the contractor's policies and procedures. To assess the mechanisms that SBA uses to help ensure that only eligible businesses participate in the program, we reviewed policies and procedures established by SBA for certifying and monitoring HUBZone firms and internal control standards for federal agencies. We compared the actions that SBA took to its policies and procedures and selected internal control standards. In examining such compliance, we analyzed data from the HUBZone Certification Tracking System (the

¹GAO, *Small Business Administration: Additional Actions Are Needed to Certify and Monitor HUBZone Businesses and Assess Program Results*, GAO-08-643 (Washington, D.C.: Jun. 17, 2008).

report information on their applications. However, we found that SBA requested documentation or conducted site visits of firms to validate the self-reported data in only limited instances. Our analysis of the 125 applications submitted in September 2007 showed that SBA requested supporting documentation for 36 percent of the applications and conducted one site visit. While SBA's policies and procedures require program examinations—the one process that consistently includes reviews of supporting documentation—the agency conducts them on 5 percent of certified HUBZone firms each year. Further, SBA has a policy of recertifying firms every 3 years, yet more than 4,600 of the firms that have been in the program for at least 3 years (about 40 percent) have not been recertified. SBA also decertifies firms (removes them from the list of certified firms), after determining that they no longer meet eligibility criteria. However, in fiscal years 2006 and 2007, of the more than 3,600 firms proposed for decertification, more than 1,400 were not processed within SBA's informal goal of 60 days. As a result of a lack of controls (or limited application of controls) and weaknesses in the application and monitoring-related processes, SBA lacks assurances that only eligible firms participate in the program.

- Finally, SBA has taken limited steps to assess the effectiveness of the HUBZone program, and from 2003 to 2006 federal agencies did not meet the government-wide contracting goal for the HUBZone program. Federal agencies are required to identify results-oriented goals and measure performance toward the achievement of their goals. SBA tracks the number of firms certified or recertified, the annual value of contracts awarded to HUBZone firms, and the number of program examinations completed annually, but has not devoted resources to completing an evaluation of the program. Consequently, SBA lacks key information that could help it better manage and assess the results of the program. We also found that most federal agencies did not meet their HUBZone contracting goals during fiscal year 2006. While the percentage of prime contracting dollars awarded to HUBZone firms increased in each fiscal year from 2003 to 2006, the 2006 awards fell short of the government-wide 3 percent goal by about one-third.

To improve SBA's administration and oversight of the HUBZone program, we recommended in our recent report that SBA correct and update its HUBZone map, develop and implement guidance to ensure more routine verification of application data, eliminate its backlog of recertifications, formalize and adhere to a specific time frame for decertifying ineligible firms, and further assess the effectiveness of the program. SBA agreed with our recommendations and outlined steps that it plans to take to address each of them.

federal statute, with some exceptions. These are all lands within the limits of any Indian reservation, all dependent Indian communities within U.S. borders, and all Indian allotments. In addition, portions of the State of Oklahoma qualify because they meet the Internal Revenue Service's definition of "former Indian reservations in Oklahoma."

- *Redesignated areas.* These are census tracts or nonmetropolitan counties that no longer meet the economic criteria but remain eligible until after the release of the 2010 decennial census data.
- *Base closure areas.* Areas within the external boundaries of former military bases that were closed by the Base Realignment and Closure Act (BRAC) qualify for HUBZone status for a 5-year period from the date of formal closure.

In order for a firm to be certified to participate in the HUBZone program, it must meet the following four criteria:

- the company must be small by SBA size standards;⁵
- the company must be at least 51 percent owned and controlled by U.S. citizens;⁶
- the company's principal office—the location where the greatest number of employees perform their work—must be located in a HUBZone;⁷ and
- at least 35 percent of the company's full-time (or full-time equivalent) employees must reside in a HUBZone.

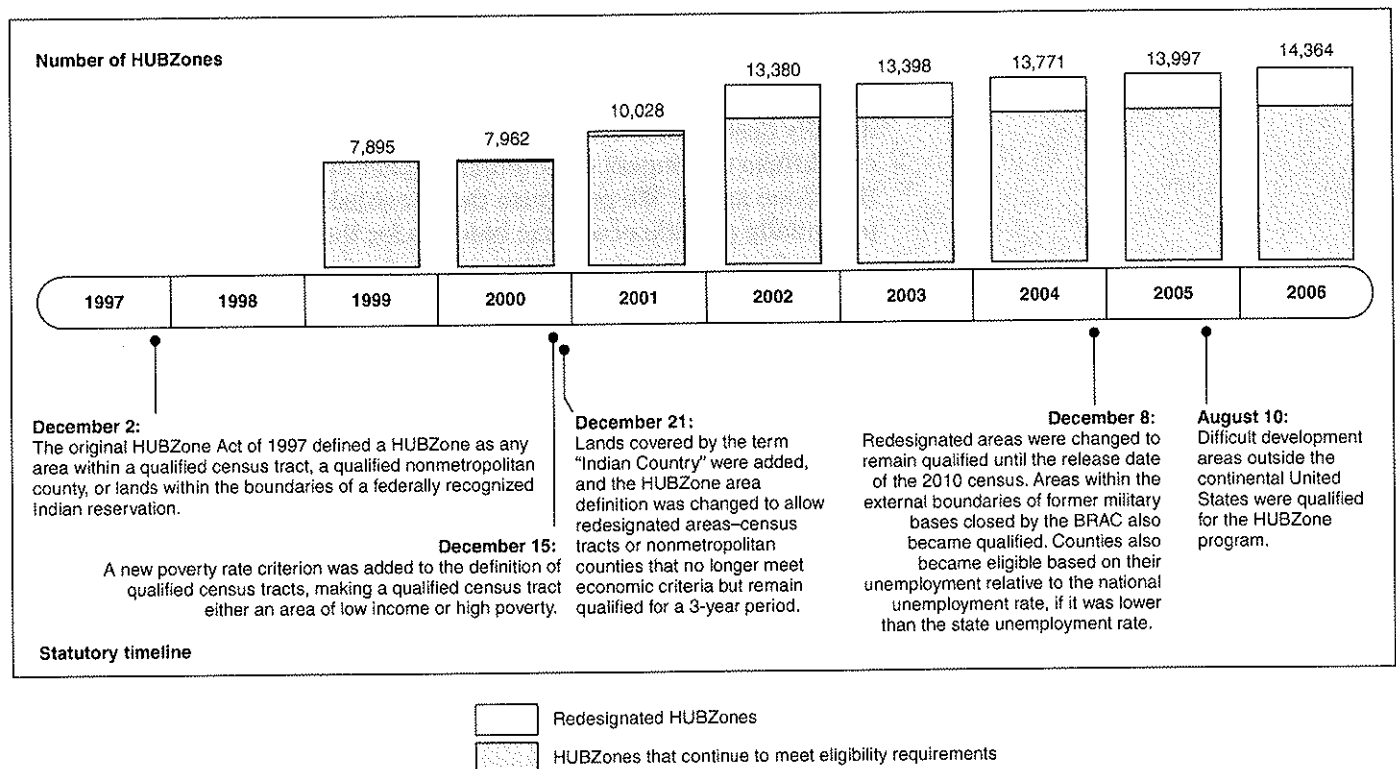
As of February 2008, 12,986 certified firms participated in the HUBZone program. More than 4,200 HUBZone firms obtained approximately \$8.1 billion in federal contracts in fiscal year 2007. The annual federal

⁵SBA's size standards are almost always stated either as the average employment or average annual receipts of a business concern and vary by industry.

⁶Qualified HUBZone firms also can be owned and controlled by Alaskan Native Corporations, Indian tribal governments, community development corporations, and agricultural cooperatives.

⁷While a small business must have its principal office in a HUBZone area, it does not have to limit its work to that HUBZone. Certified HUBZone businesses can bid on and receive federal contracts for work to be performed anywhere; that is, HUBZone contracts are not limited to HUBZone areas.

Figure 1: Statutory Changes to Definitions for HUBZone Areas and Effect on Number of HUBZones, 1997–2006



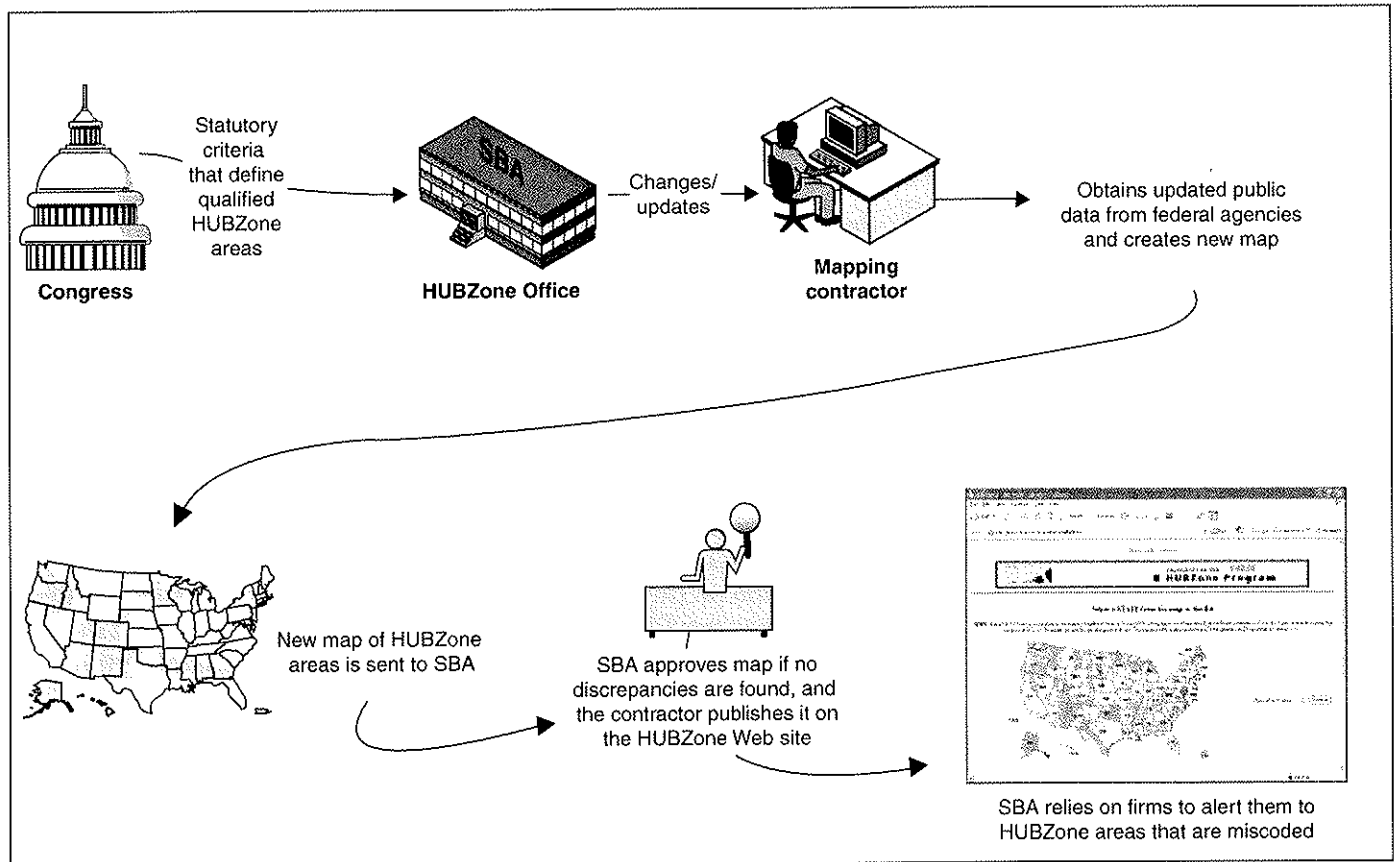
Source: GAO analysis of SBA data.

In expanding the types of HUBZone areas, the definition of economic distress has been broadened to include measures that were not in place in the initial statute. For example, a 2000 statute amended the HUBZone area definition to allow census tracts or nonmetropolitan counties that ceased to be qualified to remain qualified for a further 3-year period as "redesignated areas."⁹ A 2004 statute permitted these same areas to remain qualified until the release date of the 2010 census data.¹⁰ Further, in 2005, Congress expanded the definition of a qualified nonmetropolitan county to include

⁹HUBZones in Native America Act of 2000, Pub. L. No. 106-554, Title VI, Subtitle A, § 604, 114 Stat. 2763, 2763A-698 (2000).

¹⁰Small Business Reauthorization and Manufacturing Assistance Act of 2004, Pub. L. No. 108-447, Div. K, ch. 3, subtitle E, § 152(c), 118 Stat. 2809, 3457 (2004).

Figure 2: Process Used to Map HUBZone Areas



Sources: GAO analysis of SBA documents and interviews; Art Explosion (images).

During the course of our review, we identified two problems with SBA's HUBZone map. First, the map includes some areas that do not meet the statutory definition of a HUBZone area. As noted previously, counties containing difficult development areas are only eligible in their entirety for the HUBZone program if they are not located in a metropolitan statistical area. However, we found that SBA's HUBZone map includes 50 metropolitan counties as difficult development areas that do not meet this

SBA Has Limited Controls to Ensure That Only Eligible Firms Participate in the HUBZone Program

Our June 2008 report also found that the policies and procedures upon which SBA relies to certify and monitor firms provide limited assurance that only eligible firms participate in the HUBZone program. While internal control standards for federal agencies state that agencies should document and verify information that they collect on their programs, SBA obtains supporting documentation from firms in limited instances. In addition, SBA does not follow its own policy of recertifying all firms every 3 years, and has not met its informal goal of 60 days for removing firms deemed ineligible from its list of certified firms.

SBA Largely Relies on Self-Reported Data for HUBZone Certifications and Recertifications, Increasing the Risk That Ineligible Firms Can Participate

Firms apply for HUBZone certification using an online application system, which according to HUBZone program officials employs automated logic steps to screen out ineligible firms based on the information entered on the application. For example, firms enter information such as their total number of employees and number of employees that reside in a HUBZone. Based on this information, the system then calculates whether the number of employees residing in a HUBZone equals 35 percent or more of total employees, the required level for HUBZone eligibility. HUBZone program staff then review the applications to determine if more information is required. While SBA's policy states that supporting documentation normally is not required, it notes that agency staff may request and consider such documentation, as necessary. No specific guidance or criteria are provided to program staff for this purpose; rather, the policy allows staff to determine what circumstances warrant a request for supporting documentation. In determining whether additional information is required, HUBZone program officials stated that they generally consult sources such as firms' or state governments' Web sites that contain information on firms incorporated in the state.¹⁴ SBA ultimately approves the majority of applications submitted. For example, in fiscal year 2007, SBA approved about 78 percent of the applications submitted.

To ensure the continued eligibility of certified HUBZone firms, SBA requires firms to resubmit an application. That is, to be recertified, firms re-enter information in the online application system, and HUBZone program officials review it. In 2004, SBA changed the recertification

¹⁴For example, the Georgia Secretary of State's Web site contains a search feature that provides information such as the principal office address for firms incorporated in Georgia.

According to HUBZone program officials, they did not more routinely verify the information because they generally relied on their automated processes and status protest process.¹⁷ For instance, they said they did not request documentation to support each firm's application because the application system employs automated logic steps to screen out ineligible firms. For example, the application system calculates the percentage of a firm's employees that reside in a HUBZone and screens out firms that do not meet the 35 percent requirement. But the automated application system would not necessarily screen out applicants that submit false information to obtain a HUBZone certification.

Rather than obtaining supporting documentation during certification and recertification on a more regular basis, SBA waits until it conducts program examinations of a small percentage of firms to consistently request supporting documentation. Since fiscal year 2004, SBA's policy has been to conduct program examinations on 5 percent of firms each year.¹⁸ From fiscal years 2004 through 2006, nearly two-thirds of firms SBA examined were decertified, and in fiscal year 2007, 430 of 715 firms (about 60 percent) were decertified or proposed for decertification.¹⁹ The number of firms decertified includes firms that the agency determined were ineligible and were decertified, and firms that requested to be decertified. Because SBA limits its program examinations to 5 percent of firms each year, firms can be in the program for years without being examined. For example, we found that 2,637 of the 3,348 firms (approximately 79 percent) that had been in the program for 6 years or more had not been examined. In addition to performing program examinations on a limited number of firms, HUBZone program officials rarely conduct site visits during program examinations to verify a firm's information.

In our report, we recommended that SBA develop and implement guidance to more routinely and consistently obtain supporting documentation upon application and conduct more frequent site visits, as appropriate, to

¹⁷The HUBZone status protest process allows SBA, contracting officers, or any interested party to protest the qualified HUBZone status of any awardee or apparent awardee of a federal contract. An interested party is any firm that submits an offer for a specific HUBZone contract or submits an offer in full and open competition and whose opportunity for award will be affected by a price evaluation preference given to a qualified HUBZone firm.

¹⁸Before fiscal year 2004, program examinations were conducted on an as-needed basis.

¹⁹These are results of GAO analysis of data from the HUBZone Certification Tracking System (as of Jan. 22, 2008).

SBA Lacks a Formal Policy on Timeframes for Decertifying Firms, Which Provides Ineligible Firms with an Opportunity to Obtain Contracts

While SBA policies for the HUBZone program include procedures for certifications, recertifications, and program examinations, they do not specify a timeframe for processing decertifications—the determinations subsequent to recertification reviews or examinations that firms are no longer eligible to participate in the HUBZone program. Although SBA does not have written guidance for the decertification timeframe, the HUBZone program office negotiated an informal (unwritten) goal of 60 days with the SBA Inspector General (IG) in 2006.²² In recent years, SBA ultimately decertified the vast majority of firms proposed for decertification, but has not met its 60-day goal consistently (see table 1). From fiscal years 2004 through 2007, SBA failed to resolve proposed decertifications within its goal of 60 days for more than 3,200 firms. While SBA's timeliness has improved, in 2007, more than 400 (or about 33 percent) were not resolved in a timely manner. As a consequence of generally not meeting its 60-day goal, lags in the processing of decertifications have increased the risk of ineligible firms participating in the program.

Table 1: Summary of SBA's Efforts to Decertify Ineligible Firms for the HUBZone Program, Fiscal Years 2004–2007

	Year firms proposed for decertification			
	2004	2005	2006	2007 ^a
Firms proposed for decertification ^b	559	1,390	2,428	1,227
Withdrawn by SBA	24	18	8	14
Firms actually decertified	314	1,082	2,032	890
Firms that retained certification	217	288	370	183
Cases that have not been resolved	4	2	18	140
Number of firms proposed for decertification but not resolved within 60 days	473	1,306	1,057	408

Source: GAO analysis of data from HUBZone Certification Tracking System (as of Jan. 22, 2008).

^aSBA conducted 3,134 recertifications and program examinations, which are often precursors to proposals for decertification, in fiscal year 2007, which was 832 less than the previous year.

^bFirms that are proposed for decertification have the ability to challenge that proposed outcome through a due-process mechanism. These data are based on the year that SBA proposed the firm for decertification.

²²In May 2006, the SBA IG found that firms proposed for decertification as a result of 2004 program examinations were not processed timely and therefore recommended that the HUBZone program office set a maximum timeframe for decertifying firms and removing them from the SBA list once they no longer meet the eligibility criteria. See SBA Inspector General, *HUBZone Program Examination and Recertification Processes*, Report Number 6-23 (Washington, D.C.: May 23, 2006).

the number of program examinations completed. These measures provide some data on program activity and measure contract dollars awarded to HUBZone firms.²⁴ However, they do not directly measure the program's effect on firms (such as growth in employment or changes in capital investment) or directly measure the program's effect on the communities in which the firms are located (for instance, changes in median household income or poverty levels).

Similarly, the Office of Management and Budget (OMB) noted in its 2005 Program Assessment Rating Tool (PART) that SBA needed to develop baseline measures for some of its HUBZone performance measures and encouraged SBA to focus on more outcome-oriented measures that better evaluate the results of the program.²⁵ The PART assessment also documented plans that SBA had to conduct an analysis of the economic impact of the HUBZone program on a community-by-community basis using data from the 2000 and 2010 decennial census. However, SBA officials indicated that the agency has not devoted resources to implement either of these strategies for assessing the results of the program. Yet by not evaluating the HUBZone program's benefits, SBA lacks key information that could help it better manage the program and inform the Congress of its results.

As part of our work, we conducted site visits to four HUBZone areas (Lawton, Oklahoma; Lowndes County, Georgia; and Long Beach and Los Angeles, California) to better understand to what extent stakeholders perceived that the HUBZone program generated benefits. For all four HUBZone areas, the perceived benefits of the program varied, with some firms indicating they have been able to win contracts and expand their firms and others indicating they had not realized any benefits from the program. Officials representing economic development entities varied in their knowledge of the program, with some stating they lacked

²⁴Our assessment of the databases that contain information on the agency's performance measures—the HUBZone Certification Tracking System and Federal Procurement Data System-Next Generation—concluded that these data were sufficiently reliable for the purposes of reporting on services provided to HUBZone firms and contracts awarded to HUBZone firms.

²⁵OMB's PART evaluation rates programs on four critical elements—program purpose and design, strategic planning, program management, and program results/accountability. The answers to questions in each of the four sections result in a numeric score for each section from 0 to 100 (100 being the best). These scores are then combined to achieve an overall qualitative rating of Effective, Moderately Effective, Adequate, or Ineffective.

In fiscal year 2006, 8 of 24 federal agencies met their HUBZone goals.²⁷ Of the 8 agencies, 4 had goals higher than the 3 percent requirement and were able to meet the higher goals. Of the 16 agencies not meeting their HUBZone goal, 10 awarded less than 2 percent of their small business-eligible contracting dollars to HUBZone firms.

Madam Chairwoman, this concludes my prepared statement. I would be happy to answer any questions at this time.

Contacts and Acknowledgments

For further information on this testimony, please contact William B. Shear at (202) 512-8678 or shearw@gao.gov. Individuals making key contributions to this testimony included Paige Smith (Assistant Director), Triana Bash, Tania Calhoun, Bruce Causseaux, Alison Gerry, Cindy Gilbert, Julia Kennon, Terence Lam, Tarek Mahmassani, John Mingus, Marc Molino, Barbara Roesmann, and Bill Woods.

²⁷We limited our analysis to the 24 agencies that SBA assessed through its Small Business Procurement Scorecards, which provide an assessment of federal achievement in prime contracting to small businesses by the 24 Chief Financial Officers Act agencies.

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